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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

Docket No. 512

GENERAL TIME CORPORATION,

Petitioner,

—against—

SECURITIES AND EXCHANGE COMMISSION, TALLEY INDUSTRIES, INC., AMERICAN INVESTORS FUND, INC., and CHESTNUTT CORPORATION,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, General Time Corporation ("General Time"), prays that a writ of certiorari issue to review the Judgment of the United States Court of Appeals for the Second Circuit entered on July 31, 1968.

Opinions Below

The opinion of the Court of Appeals is unofficially reported in CCH Fed. Sec. L. Rep. ¶92,240 (2d Cir. 1968) and is printed as Appendix A hereto.

The opinion of the United States District Court for the Southern District of New York is unofficially reported in CCH Fed. Sec. L. Rep. ¶92,224 (S. D. N. Y. 1968) and is printed as Appendix B hereto.

Jurisdiction

The Judgment of the Court of Appeals reversing the dismissal of the Complaint by the District Court was entered on July 31, 1968. The jurisdiction of this Court is invoked under Title 28, U.S.C. §1254(1).

Questions Presented

Section 17(d) of the Investment Company Act of 1940 (the "Act"), 15 U.S.C. §80a-17(d) and Rule 17d-1, 17 CFR 270.17d-1 enacted thereunder by the Securities and Exchange Commission ("SEC"), require investment companies and their statutory affiliates, as defined in §2(a)-(3) of the Act, to disclose proposed joint transactions and to seek the prior approval of the SEC, before engaging in such joint transactions. In this case, respondents, Talley Industries, Inc. ("Industries") and American Investors Fund, Inc. ("Fund"), statutory affiliates under the Act, failed to disclose and seek prior approval of their joint transaction to acquire and vote General Time stock for the purpose of enabling Industries to take over General Time. It was not until after the joint transaction had been undertaken, and Industries and Fund had each completed its acquisition of General Time stock and a proxy fight for control of General Time was being waged, that Industries and Fund filed an application for *nunc pro tunc*

approval of their joint transaction. After a full evidentiary hearing upon due notice, the SEC denied the application and held that Industries and Fund had violated the Act. The SEC subsequently filed a complaint to compel Industries and Fund, as violators of the Act, *inter alia*, to withdraw their votes cast at General Time's Annual Meeting. General Time is a defendant in that action, appeared therein and fully participated in all the proceedings in support of the relief requested in the complaint.

The District Court dismissed the complaint, but the Court of Appeals upheld the SEC determination that Industries and Fund had violated §17(d) and Rule 17d-1 and reversed the District Court. It refused, however, to direct the entry of the relief sought on the ground that such relief would not benefit Fund's stockholders, whom it held to be the sole class protected by the Act.* The questions presented are:

1. Whether the Court of Appeals improperly construed §17(d) and Rule 17d-1 when it excluded portfolio companies of investment companies and the general investing public from coverage under the protective provisions of the Act.

2. Whether the Court of Appeals, after upholding the SEC determination that §17(d) and Rule 17d-1, the important disclosure and prior approval rule of the SEC under the Act, had been violated, nullified Rule 17d-1 and abrogated the powers delegated by Congress to the SEC by improperly (a) approving, *nunc pro tunc*, the application previously rejected by the SEC, thereby substituting its judgment for that of the SEC, (b) failing to direct the entry of the only meaningful relief that would make the Rule effective and (c) permitting statutory affiliates to retain the benefits of their unlawful acts and to proceed to fruition with their unlawful takeover.

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* The Court of Appeals remanded the case to the District Court with instructions to formulate an injunction in accordance with its opinion.

Statute Involved

The relevant portions of the Investment Company Act of 1940, 15 U.S.C. §§80a-1, 80a-2(a)(3), 80a-17(d), 80a-42-(e) and Rule 17d-1 (17 CFR 270. 17d-1) thereunder are set forth in Appendix C hereto.

Statement of the Case

A. The SEC Hearing and Decision

After a full evidentiary hearing upon due notice, the SEC held in a memorandum opinion and order, dated April 19, 1968, a copy of which is printed as Appendix D hereto, that Fund and Industries secretly undertook a coordinated program "to acquire GTC [General Time] stock by concerted action" in violation of §17(d) of the Act and Rule 17d-1, with the avowed purpose of enabling Industries to take over General Time.* The SEC rejected the

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* In its opinion and order, the SEC stated as follows: "Under these circumstances, we think it clear that Industries and AIF [Fund] entered into and carried out a joint arrangement within the meaning of Section 17(d) and Rule 17d-1 to acquire GTC [General Time] stock by concerted action. The broad language of that Section and Rule indicate that the term 'joint arrangement' should not be given a narrow interpretation. Here there was not a mere happenstance of simultaneous purchases of the same security by an investment company and its affiliate. On the contrary, at Industries' instigation it and AIF undertook a coordinated program of acquisitions of the GTC stock, through a common broker, MKC [M. Kimelman & Co.], pursuant to discussions between them and agreed mechanics for its execution. Further AIF was aware of Industries' ultimate objective of bringing about a merger and was influenced to purchase GTC shares by this possibility.

"Section 17(d) and Rule 17d-1 therefore were applicable and required that an application regarding the joint arrangement be filed with and granted by us prior to the taking of any action. However, the requisite prior approval was not sought or obtained, and Industries' acquisition of GTC shares pursuant to its joint arrangement was accordingly in violation of the Act." (Appendix D, p. 49a).

belated Rule 17d-1 application of Industries and Fund, filed during the ensuing proxy fight, which sought *nunc pro tunc* approval of their joint program, and held:

> "We find no warrant for granting retroactive approval of the transactions effected in such violation. The requirement that joint arrangements and transactions by investment companies and affiliates be submitted to us for our examination before any steps are taken to carry them out is an important part of the regulatory structure which is designed to effectuate the provisions, policies and purposes of the Act. One who would ask that we disregard a failure to comply with that requirement has the burden of presenting a compelling showing that such failure was justified and that retroactive approval is not inconsistent with the statutory policies and purposes. We are unable to find that such burden has been satisfied in the present situation." (Appendix D, p. 50a).

Notwithstanding the SEC opinion and order, Fund and Industries continued their unapproved arrangement by voting those illegally acquired shares in support of Industries' takeover attempt at General Time's annual meeting which began April 22, 1968. The illegally acquired shares of either Fund or of Industries represent the swing votes in the election.

B. The SEC Suit in the District Court to Enforce Compliance with its Decision

On May 1, 1968, the SEC brought suit in the District Court to compel Industries and Fund, among other things, to withdraw their votes because they had acquired the shares so voted in violation of the Act. Voting was, and still is, an integral element in the entire unlawful joint

transaction. After trial, the District Court dismissed the complaint on the ground that the Act had not been violated. The SEC appealed and obtained a stay of the reconvened meeting and of the certification of the vote pending the outcome of the appeal. As a party to the action, supporting the relief sought, General Time also participated in the appeal proceedings, filed separate briefs and presented oral argument.

C. The Court of Appeals Opinion Denying the Relief Sought by the SEC

On July 31, 1968, the Court of Appeals reversed the dismissal of the Complaint by the District Court, and upheld the SEC finding that Industries and Fund had, indeed, violated the Act.* However, the Court of Appeals refused to direct an order against voting the stock, as sought by the SEC, on the ground that the stockholders of Fund would not benefit from such relief and that "the objective of §17(d) of the Investment Company Act is to prevent affiliated persons from injuring the interests of stockholders of registered investment companies." (Appendix A, p. 17a). By limiting the protective provisions of the Act to such stockholders and excluding therefrom portfolio companies and the investing public, the Court of Appeals has effectively and improperly nullified these important protective provisions as well as the SEC's procedure and rule duly adopted thereunder.

Reasons for Granting the Writ

A. Introduction

This case presents for the first time critical questions having broad national significance—the proper construc-

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* Reconvening the annual meeting to certify the vote has been further stayed pending formulation by the District Court of an injunction consistent with the opinion of the Court of Appeals.

tion of §17(d) of the Act and Rule 17d-1, the viability of the SEC's administrative procedures under the Act and the relief available in the face of violations of the Act. The issues presented directly affect every portfolio company of a mutual fund and, by reason thereof, the investing public and the effective regulation of the securities markets.

B. This Petition is Timely and is Filed at an Appropriate Stage in the Case

The procedural status of this case is parallel to that faced by this Court when it granted certiorari in the leading securities case of *J. I. Case Co.* v. *Borak,* 377 U. S. 426 (1964). In *Borak,* as here, the Court of Appeals reversed the District Court's dismissal of the complaint and remanded the case "to the court below for further proceedings consistent with" the opinion. (317 F. 2d 838, 849 (7th Cir. 1963)). This Court granted certiorari at that point in the proceedings to determine whether federal courts had the power to grant all necessary remedial relief for violations of the proxy rules. (377 U. S. at 428). This Court then addressed itself to the scope of relief for violation of the proxy rules and stated:

> "We, therefore, believe that under the circumstances here it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." 377 U. S. at 433.

Likewise under the Securities Act of 1933 this Court has held, with respect to relief:

> "The power *to enforce* implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the pro-

cedures or actions normally available to the litigant according to the exigencies of the particular case." *Deckert* v. *Independence Shares Corp.*, 311 U. S. 282, 288 (1940).

Here, as in *Borak* and *Deckert*, the questions of the protection and the relief available under a vital securities act are in issue. Although this Court has responded to these questions with respect to the 1933 and 1934 securities acts, it has not as yet done so under §17(d) of the 1940 Act.

In this case the Court of Appeals improperly construed the 1940 Act to the substantial detriment of portfolio companies and the investing public. As in *United States* v. *General Motors Corp.*, 323 U. S. 373, 377 (1945), the Court of Appeals' opinion poses important questions "fundamental to the further conduct of the case" which should be reviewed at this time.

C. The Court of Appeals' Construction of the Act is Inconsistent With Congressional Policy and SEC Interpretations

The Congressional concern with the dominant power of mutual funds and the peril of their expanding activities upon portfolio companies and the investing public is evident in the findings and declaration of policy of the Act. There it is recognized that "investment companies are affected with a national public interest" (§80a-1(a)) and that "such companies customarily invest and trade in securities issued by, and may dominate and control or otherwise affect the policies and management of, companies engaged in business in interstate commerce" (§80a-1(a)-(3)). The concluding paragraph of §1 of the Act states that "the purposes of this title . . . shall be interpreted . . .

to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors." (Appendix C, p. 40a).

The Court of Appeals concluded that "the objective of §17(d) of the Investment Company Act is to prevent affiliated persons from injuring the interests of stockholders of registered investment companies". (Appendix A, p. 17a). Certainly, while protection of investment company stockholders is one purpose of §17(d), nothing cited by the Court of Appeals or by respondents, Industries and Fund, indicates that such protection is its exclusive purpose. In addition to the policy recited in the Act itself, recent SEC pronouncements make it unmistakenly clear that the Act is also designed to protect portfolio companies against the illegal activities presented here:

> "The Act's requirements of fairness with respect to transactions between investment companies and portfolio companies in which they hold five percent or more of the outstanding voting securities gives these portfolio companies [affiliated persons] . . . *a measure of protection against overreaching by investment companies.* . . . These provisions of the Act are a check on the power of investment companies *to use their positions as large stockholders to the detriment of portfolio companies.* . . ." (Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, House Report No. 2337, 89th Cong., 2d Sess., p. 311 (1966) (Emphasis added).

That report by the SEC also stated that the

> "Act expresses concern over investment company impact . . . on companies in which investment companies are interested." (p. 27).

Moreover, the SEC in that report confirmed the Act's protection of portfolio companies when it concluded that "there is no present need for new legislation on investment company-portfolio company relationships." (pp. 27-28).

The SEC has held on other occasions (prior to and after the report referred to above) that §17 was intended to protect parties in addition to investment companies and their stockholders.

> "In our opinion, the fact that Section 17(a) by its terms makes it unlawful for the affiliate, rather than the investment company, to engage in specified types of transactions, does not, as argued by applicants, indicate a Congressional concern for the shareholders of the investment company to the exclusion of the other stockholders affected. While it is true that the protection of fund shareholders was a primary consideration which led to the passage of the Act, we find nothing in the legislative history which persuades us that Congress intended the broad language of Section 17(b) to be read in the restrictive manner which applicants suggest, nor have we ever done so." *Fifth Avenue Coach Lines, Inc.*, CCH Fed. Sec. L. Rep. Par. 77,522, p. 83,075 at 83,077 (Investment Company Act Release No. 5214, December 27, 1967). See also *Imperial Financial Services, Inc.*, CCH Fed. Sec. L. Rep. Par. 77,287 [SEC Release No. 7684, August 26, 1965].*

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* It should be noted that a §17(b) exemption for a §17(a) transaction requires a finding by the SEC that there be no overreaching whatever "on the part of any person." Thus if the fund "overreaches", the transaction cannot be exempted from §17(a). Therefore, the protections of §17 in general are not limited to merely protecting a fund, but are, by statutory mandate, broader and protect other parties.

The unregulated use in violation of the Act by a mutual fund of its substantial resources to finance its affiliate's efforts to take over a portfolio company is in direct conflict with express Congressional policy (§80a-1-(a)(2)-(5), Appendix C, pp. 39a-40a). The Court of Appeals' decision, by allowing the wrongdoers to consummate their unlawful transaction, will thwart effective SEC regulation of abuses by mutual funds.

The SEC strenuously argued in its principal brief to the Court of Appeals, dated July 9, 1968, that "disfranchisement is necessary to vindicate the broader purposes of the Act." (p. 39). The SEC reasoned:

> "The refusal of the courts to prevent the voting would tend to render meaningless the sections of the Act which require advance submission of the transaction to the Commission, since if those required to seek such advance approval are ultimately benefitted when they fail to do so, a proliferation of instances in which such requirements is ignored might be expected." (pp. 39-40).

If the SEC prayer for relief is not granted, there will be no deterrent against similar abuses in the future. Others will be encouraged, without fear of sanction, to proceed with unapproved, and therefore unlawful, joint transactions. Such a development would be inimical to the national public interest.

D. The Court of Appeals Has Improperly Substituted Its Judgment for That of the SEC and Has Abrogated Rule 17d-1

The Court of Appeals unanimously upheld the SEC's determination that Industries and Fund had, indeed, violated the Act. It recognized the applicability of the principle "that a factual determination by an agency responsi-

ble for the execution of Congressional policy and vested with expertise shall not be disturbed by a Court where there is substantial evidence to support it" (Appendix A, p. 13a). However, the Court of Appeals ignored the SEC's refusal to approve the application of Industries and Fund on a *nunc pro tunc* basis and specifically rejected the relief against voting the stock sought by the SEC, thereby permitting Fund and Industries to retain the rewards of their wrongdoing. The Court of Appeals stated that "weight must be given to the agency's selection of remedy" only where the agency petitions for "enforcement of an order making such directions" (Appendix A, p. 17a). However, the SEC, when it brought suit to enjoin Industries and Fund from voting their General Time shares, was acting to prevent participants in an unlawful joint arrangement from continuing or consummating an unlawful transaction. That action is at the very least equivalent to a finding by the SEC that such relief is required to implement the Act.

Furthermore the Court of Appeals misconstrued §42(e) of the Act and erroneously gave no weight to the SEC's decision to bring suit to enforce that agency's own formal holding that the Act had been violated.

Section 42(e) states that "upon a showing" by the SEC that a person "has engaged in or is about to engage in any act or practice constituting a violation of any provision of this title, or of any rule, regulation, or order hereunder . . . a permanent or temporary injunction or decree or restraining order shall be granted without bond." Once a violation has been shown as it has been in this case, the Court is obligated, in the absence of capriciousness and arbitrariness, to grant the injunctive relief sought by the SEC.*

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* "Failing a gross abuse of discretion, the courts should not attempt to substitute their untutored views as to what sanctions will best accord with the regulatory powers of the Commission." *Tager* v. *SEC*, 344 F. 2d 5, 9 (2d Cir. 1965).

In neither prohibiting the voting nor granting the only meaningful relief that would make the SEC rule effective, thus permitting the unlawful joint transaction in this case to continue to fruition, the Court of Appeals has effectively approved the application of Industries and Fund on a *nunc pro tunc* basis and sanctioned the takeover of General Time by an affiliate acting jointly with a registered investment company in violation of the Act.

The Court of Appeals has not only overruled the SEC, it has also refused to defer to the expertise of the SEC on matters relating to its orderly administration of its duties under the Act. Here, it has ordered the District Court to substitute its judgment for the expertise of the SEC in fashioning an injunction. And beyond that, it has, in effect, directed the District Court to confine itself merely to a consideration of the interest of stockholders of registered investment companies. This controverts the findings and declaration of policy of the Act, as stated above, and nullifies Rule 17d-1, particularly subparagraph (b) thereof, under which the SEC determined that, among the matters to be considered in passing upon applications, are the "provisions, policies and purposes of the Act."

The importance of the requirements under Rule 17d-1, which were adopted by the SEC pursuant to statutory authorization for the protection of the general investing public, has, interestingly enough, been recognized by the Court of Appeals. It states that the "only effective method of regulation [under §17(d)] was to require advance disclosure." (Appendix A, p. 16a). This is obvious because of the infinite varieties of transactions between affiliates and investment companies that should require a full disclosure and the approval of the SEC before participants

enter into a joint arrangement. See, e.g., *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180 (1963); *SEC* v. *Texas Gulf Sulfur Co.*, CCH Fed. Sec. L. Rep. ¶ 92,251 (2d Cir. 1968). The investing public (including General Time and its stockholders) is entitled to the important benefits flowing from the application procedure, *i.e.*, advance SEC scrutiny and public disclosure and notice of joint plans of affiliates and investment companies and, as urged by the SEC, the opportunity for interested persons other than the participants to make suggestions and recommendations. Having recognized the importance of the prior disclosure and prior approval procedures, however, the Court of Appeals has effectively scuttled them by its decision.

E. The Infringement By the Court of Appeals Upon the Powers of the SEC Warrants Review by this Court

This Court has again recently demonstrated its willingness to review attempts by lower courts to infringe upon or nullify authorized administrative functions. See, *SEC* v. *New England Electric System*, 390 U. S. 207 (1968). In that case, this Court struck down a decision which "indulged in an unwarranted excursion in the administrative domain" (*Id.* at 211). The principle of that case is applicable here and warrants a grant of certiorari by this Court.

Contrary to the overly-restrictive approach of the Second Circuit, other lower federal courts have upheld the need for appropriate relief in 1940 Act cases. For example, in *SEC* v. *Quing N. Wong*, 252 F. Supp. 608 (D. P. R. 1966), the SEC sought to enjoin officers of an investment company from violating §17(d) of the Act and other securities law provisions. The relief granted included enjoining defendants from serving as officers or directors of

their investment company and other investment companies as well.

The District Court in that case held that the SEC was entitled to "complete and effective relief," including "an accounting and restitution . . . and . . . such other equitable relief as might be necessary to protect the public interest and effectuate the statutory purpose" (252 F. Supp. at 613-614).

Likewise, the First Circuit has held that when the SEC "invokes the equity powers of the Federal Court" that invocation "calls into play its inherent powers where necessary to do justice and grant full relief." *Aldred Inv. Trust* v. *SEC,* 151 F. 2d 254, 261 (1st Cir. 1945), *cert. denied,* 326 U. S. 795 (1946). Accord, *Bailey* v. *Proctor,* 160 F. 2d 78, 82 (1st Cir.), *cert. denied,* 331 U. S. 834 (1947).

If the relief sought by the SEC is not granted, Industries and Fund will realize the fruits of their wrongdoing—an unlawful takeover of General Time. But it is well-established that "an offender" against the securities laws "should not be permitted to retain the avails of his wrongdoing." *SEC* v. *Central Foundry Co.,* 167 F. Supp. 821, 827 (S. D. N. Y. 1958). "The principle is fundamental that no man shall be permitted to profit by his own wrong. It enters, by implication, into all contracts and all laws . . ." Cardozo, J., in *People* v. *Schmidt,* 216 N. Y. 324, 341, 110 N. E. 945, 950 (1915). See, II Loss, *Securities Regulation* (2d Ed. 1961), p. 957.

Meaningful relief should not be denied in this case. No principle of law requires that stockholders of a wrongdoer (Fund) should be enriched at the expense of innocent third parties. The redress of these stockholders is against the managers and officers of the Fund who violated the law. In any event, concern for Fund's stockholders should

not extend to Industries, the affiliated person, which is attempting to shield its violation behind the veil of the Fund's stockholders. *United States* v. *E. I. du Pont de Nemours & Co.*, 366 U. S. 316, 326-327 (1961); *United States* v. *Crescent Amusement Co.*, 323 U. S. 173, 189-190 (1944); *Vanadium Corp. of America* v. *Susquehanna Corp.*, 203 F. Supp. 686, 699 (D. Del. 1962). The unlawfulness of Industries' acquisition of General Time shares was made clear in the SEC opinion and order of April 19, 1968: "Industries' acquisition of GTC [General Time] shares pursuant to its joint arrangement was accordingly in violation of the Act." (Appendix D, pp. 49a-50a).

CONCLUSION

For the foregoing reasons, this Petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 573—September Term, 1967.

(Argued July 22, 1968 Decided July 31, 1968.)

Docket No. 32506

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

—v.—

TALLEY INDUSTRIES, INC., AMERICAN INVESTORS FUND, INC., CHESTNUTT CORPORATION, and GENERAL TIME CORPORATION,

Defendants-Appellees.

Before:

FRIENDLY, HAYS and FEINBERG,

Circuit Judges.

Appeal by the Securities and Exchange Commission from an order of the District Court for the Southern District of New York, Inzer B. Wyatt, *Judge,* dismissing its complaint which alleged that an affiliate of a registered investment company had effected a transaction wherein the investment company was a joint or a joint and several participant, in violation of §17(d) of the Investment Company Act of 1940 and the Commission's Rule 17d-1. Reversed.

JOHN A. DUDLEY, Special Counsel (Philip A. Loomis, Jr., General Counsel, David Ferber, Solicitor, Anthony A. Vertuno, Anthony G. Gamer, Attorneys, Securities and Exchange Commission, Washington, D. C.; Mahlon M. Frankhauser, Regional Administrator, Richard V. Bandler, Associate Regional Administrator, Edwin H. Nordlinger, Attorney, New York, N. Y., of Counsel), *for Securities and Exchange Commission.*

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FRIENDLY, *Circuit Judge*:

For the second time this term, see *SEC* v. *Sterling Precision Corporation*, 393 F. 2d 214, we are confronted with a close question of interpretation of §17 of the Investment Company Act of 1940, 54 Stat. 815, setting limits on "Transactions of Certain Affiliated Persons and Underwriters."

On this occasion we believe the district judge construed the relevant clause, §17(d), too narrowly, reverse his judgment dismissing the complaint, and direct further appropriate proceedings.

I.

Section 17(d), so far as here relevant, provides as follows:

> (d) It shall be unlawful for any affiliated person of or principal underwriter for a registered investment company (other than a company of the character described in section 12(d)(3)(A) and (B)), or any affiliated person of such a person or principal underwriter, acting as principal to effect any transaction in which such registered company, or a company controlled by such registered company, is a joint or a joint and several participant with such person, principal underwriter, or affiliated person, in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant.

Defendant Talley Industries, Inc. (hereafter Industries) is an "affiliated person" of defendant American Investors Fund, Inc. (hereafter Fund), a registered investment company, by virtue of Fund's owning 9% of Industries' voting shares, see §2(a)(3)(B). As a result of discussions between Franz G. Talley, president of Industries, a company having a net worth of some $10 million, and Michael Kimelman, a partner in the brokerage firm of M. Kimelman & Co., in which Kimelman advanced General Time Corporation, a

much larger corporation, as a candidate for acquisition by a merger with Industries, Talley gave Kimelman an order under which he bought 24,800 shares of General Time for Industries on December 26 and 27, 1967; the price was around $23 or $24 per share. This was only some 1% of the outstanding stock of General Time, a long way from what Talley thought would be needed to afford a prospect of success if he should decide to go forward with an acquisition or merger proposal.

On December 29, 1967, Talley telephoned Fund's office, and ultimately spoke to George A. Chestnutt, Jr., president of Fund and of Chestnutt Corporation, its investment adviser. Talley told him that Industries had bought stock in a certain company which he viewed as a possible merger candidate and that he had in mind that Fund also might wish to buy some stock. Chestnutt broke off the conversation to consult his counsel. The latter advised that Fund could follow Talley's suggestion so long as it "maintained complete independence in our acquisition of stock and didn't make any promises or arrangements" as to voting, disposition or otherwise. Chestnutt relayed this to Talley, who accepted Fund's proceeding in this manner. Talley then named the company, saying he thought it a good investment that might become better under a more aggressive management. He indicated that Industries intended to buy more General Time stock in the market, with an eye toward a merger; Chestnutt got the impression that Talley was thinking of terms that would yield around $45 in Industries securities for each share of General Time. Talley proposed that Kimelman get in touch with Chestnutt; the latter, after telling Talley that 10% of the General Time stock would be his legal limit, said he would study his own data on the company, would like to see Kimelman, and would

think the whole thing over. Shortly thereafter Industries bought 42,000 shares of General Time.

Kimelman visited Chestnutt on January 3. Next day Chestnutt determined that Fund should take a position in General Time. He was motivated both by study of the company's earnings and by a belief that if Industries sought a merger, the stock would rise as a result of that offer or of others it might stimulate. On January 5 Fund placed an order with Kimelman for 205,000 shares, subsequently increased to 210,000, just under Fund's 10% limit, on a "not-held" basis, i.e., with the time of execution at the broker's discretion. Chestnutt reported this to Talley.

Chestnutt maintained close supervision of Kimelman's purchases, insisting that on days when Kimelman had "not held" orders from other customers, shares should be allocated so as not to favor another customer over Fund. Industries was also making some purchases of General Time through Kimelman but at least on one occasion agreed to forego allocation and accept the most expensive shares. By February 15 Fund had acquired 210,000 shares at an average cost of $28.49 per share.

During the first week of January 1968, Talley discussed the situation, including his initial conversation with Chestnutt, with his counsel, who did not mention §17(d). After some backing and filling unnecessary to recount, Industries resumed purchases of General Time toward the end of January. Talley talked to Chestnutt four or five times during January and reported how many shares he thought "were being acquired by the Kimelmans and himself and his friends and so on." He would give Chestnutt percentage figures of what "we have" and these rather obviously included the holdings of Fund. On February 5 Industries sold 40,000 shares to Donald Harrington, a friend of Talley's, who later increased his holdings to 104,500 shares.

Finding that the record date for General Time's annual meeting was March 1, somewhat earlier than he had believed, and that Industries' own holding were only some 52,000 shares, about 2½% of the stock as against the 10% he considered necessary for a meaningful merger proposal, Talley made a special bid on the advice of his investment bankers, Smith, Barney & Co., and against that of Chestnutt who thought this would drive the price up and would not get Industries the amount of stock it wanted. The bid, on February 19, 1968, was for 200,000 shares at 36½. General Time denounced this as "grossly inadequate" and said it had a higher offer, on a tax-free basis, from another company. Only 66,437 shares were acquired.

On the afternoon of February 19, a meeting was held at Smith, Barney & Co. at the instance of the management of General Time. Talley proposed a merger and said "We and our associates own about a third of the stock"—a figure which included Fund's holdings. Later that evening the management sent word to Talley it had decided to fight. Industries, which then owned 118,537 shares, about 5½% of the total, went back into the market and quickly bought another 139,400 shares at prices ranging from 41½ to 43½. This brought its holdings to 257,937 shares, about 12½%, at an average cost of $36.76 per share.

General Time's response was an action in the District Court for the Southern District of New York alleging *inter alia* a violation of §17(d) of the Investment Company Act and seeking an injunction against the voting of the stock, the obtaining of more, or any merger. Judge Bryan dismissed the action for lack of standing; General Time appealed. Meanwhile Industries selected ten nominees of an "Independent Stockholders Committee" for election as directors at the annual meeting of General Time on April

22, obtained a stockholders list only after litigation in Delaware, and sought to clear its proxy material with the SEC. On March 25 the SEC staff advised that the material would not be cleared unless Industries filed an application for approval of the acquisition of General Time stock by Fund and Industries under Rule 17d-1, which we reproduce in relevant part in the margin.[1] Industries filed such an application, with appropriate disclaimers of the need for

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1 Rule 17d-1. Applications Regarding Joint Enterprises or Arrangements and Certain Profit-Sharing Plans.

(a) No affiliated person of or principal underwriter for any registered investment company (other than a company of the character described in Section 12(d)(3) (A) and (B) of the Act) and no affiliated person of such a person or principal underwriter, acting as principal, shall participate in, or effect any transaction in connection with, any joint enterprise or other joint arrangement or profit-sharing plan in which any such registered company, or a company controlled by such registered company, is a participant, and which is entered into, adopted or modified subsequent to the effective date of this rule, unless an application regarding such joint enterprise, arrangement or profit-sharing plan has been filed with the Commission and has been granted by an order entered prior to the submission of such plan or modification to security holders for approval, or prior to such adoption or modification if not so submitted, except that the provisions of this rule shall not preclude any affiliated person from acting as manager of any underwriting syndicate or other group in which such registered or controlled company is a participant and receiving compensation therefor.

(b) In passing upon such application, the Commission will consider whether the participation of such registered or controlled company in such joint enterprise, joint arrangement or profit-sharing plan on the basis proposed is consistent with the provisions, policies and purposes of the Act and the extent to which such participation is on a basis different from or less advantageous than that of other participants.

(c) "Joint enterprise or other joint arrangement or profit-sharing plan" as used in this rule shall mean any written or oral plan, contract, authorization or arrangement, or any practice of understanding whereby a registered investment company or a controlled company thereof and any affiliated person of or a principal underwriter for such registered investment company, or any affiliated person of such a person or principal underwriter, have a joint or a joint and several participation or share in the profits of such enterprise or undertaking, but shall not include an investment advisory contract subject to Section 15 of the Act.

doing so; a hearing was set for April 16; and the proxy material was cleared.

General Time then started a new action in the District Court for the Southern District of New York, claiming the proxy material was false and misleading in violation of §14 of the Securities Exchange Act of 1934. Judge Tyler denied a preliminary injunction on April 11. On the next day Chestnutt was asked whether he would consider an offer for Fund's holdings in General Time from Del Coleman, president of Seeburg Corporation having its headquarters in Illinois. He countered by saying that he would be "down in front of the SEC testifying on the General Time situation next week, probably Tuesday" and might have to reveal anything that was said. Coleman first drew back but then asked whether Chestnutt would entertain a cash offer of $40 a share. Chestnutt replied that he would have to compare this with what anyone else might offer.[2]

April 13 saw the announcement of a plan to merge General Time and Seeburg Corporation, "contingent upon the continuation of General Time's present management." The details appeared on April 15. Chestnutt found the terms "shockingly unattractive"; he thought they would work out at not more than $28 per share of General Time as against a current market of $35. This, according to Chestnutt, was what made him decide to vote Fund's shares for the Committee's nominees and against the management.

The SEC hearings were held April 16, 17 and 18, oral argument was had before the Commission on April 19, and the Commission issued a Memorandum Opinion and Order

2 Chestnutt also testified that a representative of Seeburg said, "You just name a price between 35 and 50 and we will talk business." Chestnutt named no price because he didn't feel "in a position to make such an offer without talking to counsel." Counsel advised that a sale at a premium might present a problem under *Perlman* v. *Feldman*, 219 F. 2d 173 (2 Cir.), cert. denied, 349 U. S. 952 (1955).

that afternoon.[3] Concluding that Industries and Fund had entered into and carried out a joint arrangement under §17(d), that application for approval should have been made under Rule 17d-1, and that there was "no warrant for granting retroactive approval of the transactions effected in such violation," the Commission denied the application. It made no direction beyond an assertion in a footnote of its "continuing jurisdiction . . . over any future transfers by Industries of the GTC stock it has acquired . . . ."[4]

On April 22, after a further unsuccessful attempt by General Time to secure an injunction from Judge Tyler, the stockholders met, the ballots were cast, and the meeting was adjourned to May 3 so that the inspectors could count the votes and certify the result. Preliminary reports indicate a victory for Industries' slate, although by a margin considerably less than the shares voted by Fund.

On May 1, the SEC began this action in the District Court for the Southern District of New York. Asserting violation of §17(d) and Rule 17d-1 by Industries and Fund, the complaint sought temporary and permanent relief enjoining further acquisition of General Time stock, requiring Industries and Fund to withdraw any votes cast at the stockholders' meeting, enjoining the voting of such shares

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3 The opinion of the district judge states the facts as to an April 3 letter written to the Commission by the junior Senator from Illinois on stationery of the Senate Committee on Banking and Currency of which he is a member, avowedly at the instance of General Time, "an important factor in the economy of Illinois and other States, as well as a producer of essential military and other items." While we do not suppose this letter had the slightest effect, it was unnecessary, to say the least. Senators and Representatives who are importuned by constituents to engage in such epistolary efforts might do well to keep at hand Senator George Norris' classic letter of declination, quoted in Landis, The Administrative Process, 101-04 (1938).

4 Industries has filed a petition in the 9th Circuit to review this order.

for nominees proposed by Industries or for any merger with Industries, and enjoining future violations by Industries and Fund. The parties agreed that the court should order the trial to be advanced and consolidated with the hearing on the application for a preliminary injunction, see F. R. Civ. P. 65(a)(2). After trial Judge Wyatt delivered an opinion directing dismissal of the complaint, this appeal followed, and we have given it expedited treatment. Meanwhile the stockholders' meeting of General Time has been adjourned at first by stipulation and later by a stay issued by this court.

II.

The first issue is whether the SEC may lawfully conclude that when an affiliated person and a registered investment company engage in a plan to achieve together a substantial stock position in another company, they can have effected "any transaction in which such registered company . . . is a joint or a joint and several participant" with the affiliate even though there is no legally binding agreement between them; we postpone the related issue whether if that proposition be affirmed, the facts here sufficiently disclose such a plan.

Little purpose would be achieved by tired-eye scrutiny of the word "transaction." This is not a technical term; "transact" means "To prosecute negotiations; to carry on business; to have dealings . . . ." Webster's New International Dictionary (2d ed.) 2688. If any investment company and an affiliate agreed that each would buy 20% of the stock of a third company and would not sell without the other's consent, the case would evidently come within §17(d), and it would be altogether immaterial whether "transaction" was read to refer to each purchase or the

entire course of dealing or both. The real issue concerns the phrase "is a joint or a joint and several participant." [5]

We begin by conceding that, on a quick reading, such black-letter words call up an image of situations where there is a considerable degree of common understanding. Industries argues, in a conspicuously able brief, that this conclusion is reinforced by §12(a)(2) which forbids any registered investment company, in contravention of Commission rules, regulations or orders, "to participate on a joint or a joint and several basis in any trading account in securities . . . ," this rather obviously contemplating a situation where definite legal obligations are fixed. Against this, however, §17(d) must have been intended to reach situations not already covered by §12(a). Furthermore any idea that §17(d) is limited to the typical joint venture in which each of the parties has a fractional share is negated by the point that its very bite is to limit or prevent participation by the investment company "on a basis different from or less advantageous than that" of the affiliated person.

We find it hard to believe that a Congress which had declared "that the national public interest and the interest of investors are adversely affected . . . when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof . . . rather than in the interest of all

5 We thus find it unnecessary to discuss the issue, much debated by the parties, whether the SEC went beyond the statute when it added the words in Rule 17d-1(a), "in connection with, any joint enterprise or other joint arrangement or profit-sharing plan. . . ." In defining these terms subdivision (c) requires that the affiliate and the investment company "have a joint or a joint and several participation" or—not here contended—"share in the profits of such enterprise or undertaking." Hence, as to this case the critical question under the Rule is the same as under the statute.

classes of such companies' security holders," §1(b)(2), meant "a joint or a joint and several participant" to be read in light of common law concepts of jointness. The need for a liberal construction in order to effectuate the statutory purpose would be clearer if, for example, Industries had been an affiliate because of its holding of 5% or more of the voting securities of Fund, §2(a)(3)(A), rather than the reverse. Yet if "joint" embraces a loose kind of combination in cases of the former type where the case for a liberal construction is strong, as held by Judge Nordbye with respect to directors in *SEC* v. *Midwest Technical Development Corp.*, CCH Fed. Sec. L. Reptr. ¶91,252 (D. Minn. 1963), it must also do that here where the case is less so[6] —and this even though the strict letter of the statutory command is limited to the affiliate. Moreover, Congress could have thought that downstream affiliation also involved some danger that the investment company's stockholders might be put upon for the benefit of other stockholders of the affiliate.[7] "Joint" can mean not only "joined" or "united" but "combined." Webster's New International Dictionary (2d ed.) 1339. The case is thus appropriate for application

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6 *SEC* v. *Sterling Precision Corporation, supra,* 393 F. 2d 214, does not support the view that the same language can be read one way in the case of upstream and another way in the case of downstream affiliation. We there declined to expand the word "purchase" in §17(a)(2) to include a redemption by a downstream affiliate of its securities held by the investment company when a "sale" to the investment company of securities of the investment company held by an affiliate, whether downstream or upstream, admitted by the SEC to include a redemption, had been expressly excluded by Congress in §17(a)(1).

7 We have noted the Commission's Proposal, Investment Company Act Release No. 5128, Oct. 13, 1967, to modify Rule 17d-1 "to provide more precise standards for the determination whether and when an application must be filed" and in that connection to narrow the cases where application must be made. See particularly proposed paragraph (e).

of the settled principle that when administration of a statute has been confided to a regulatory agency and a statutory term is reasonably capable of the interpretation the agency has given, a court will sustain this even though it might have reached a different conclusion if the issue had arisen otherwise. *Gray* v. *Powell,* 314 U. S. 402, 411-13 (1941); *NLRB* v. *Hearst Publications, Inc.,* 322 U. S. 111, 130-32 (1944); *CIR* v. *Pepsi-Cola Niagara Bottling Corp.,* —— F. 2d ——, —— (2 Cir. 1968).

Even on that view, however, some element of "combination" is required. Industries forcefully contends this to be negated, particularly by Chestnutt's statement to Talley before Fund had even decided to make purchases of General Time. But here Industries encounters the Commission's decision to the contrary. Passing for the moment the question of the validity of the portion of Rule 17d-1 authorizing the hearing conducted by the SEC, we cannot subscribe to Industries' argument that in any event the administrative proceeding was "without legal significance," so that, as in *SEC* v. *Frank,* 388 F. 2d 486, 491 (2 Cir. 1968), the Commission was cast in the district court in the same role as a private litigant as regards factual issues. To be sure the case is not here on a petition to review the SEC's order denying Industries' application for retrospective approval, and the provision of §43(a) making its findings conclusive if supported by substantial evidence thus is not applicable by its terms. But the principle underlying that rule—that a factual determination by an agency responsible for the execution of Congressional policy and vested with expertise shall not be disturbed by a court where there is substantial evidence to support it—applies none the less, and it would be little short of absurd for us to decline to follow the same

standard by which a court reviewing the Commission's order would be bound. Cf. *SEC* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 113-27 (1949).

Our summary of the facts shows there was substantial evidence here. While no one has cast doubt on the veracity of Chestnutt's testimony as to his initial conversation with Talley, this did not preclude the Commission's drawing a contrary inference of intention from what the parties actually did. Indeed developments may well have brought Industries and Fund into a "combination" not clearly envisioned by either at the outset; war and the threat of war have always been powerful forgers of alliances. The Commission was justified in using its knowledge of the unspoken customs of the business world to conclude that, after Chestnutt had seen Industries spend over $8,300,000 in acquiring the 205,837 shares purchased in the special offer and on February 21 and 23, he was no longer a completely free agent as to the 210,000 shares Fund had purchased, on Talley's recommendation, for about 70% of that price. Experienced business men must have known at the outset that such a situation might arise. "An administrative agency with power after hearings to determine on the evidence in adversary proceedings whether violations of statutory commands have occurred may infer within the limits of the inquiry from the proven facts such conclusions as reasonably may be based upon the facts proven. One of the purposes which lead to the creation of such boards is to have decisions based on evidential facts under the particular statute made by experienced officials with an adequate appreciation of the complexities of the subject which is entrusted to their administration." *Republic Aviation* v. *NLRB*, 324 U. S. 793, 800 (1945).

III.

The other serious issue of construction is whether, in seeking to implement §17(d) by a general requirement of advance application and approval, Rule 17d-1 exceeds the authority granted by Congress. Industries contends that the power conferred by §17(d) was to prescribe *substantive* rules and regulations "for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant"; that the Commission has prescribed none but rather has unlawfully insisted on advance application and approval in every case; that the transaction thus must be deemed lawful since no valid rule or regulation prohibited it; or, at the very least, that it should be upheld because Industries did not acquire General Time stock "on a basis different from or less advantageous than that of" Fund. The issue must be considered in light of the general power conferred on the SEC by §38(a) "to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this title . . . ."[8]

Here again, while initial reaction may favor Industries' contention, reflection sustains the Commission's view. The

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8 Industries makes a point of the Commission's current effort to have Congress amend §38(a) to conform its language to that, e.g., in §20(a) of the Public Utility Holding Company Act, which empowers the SEC "to make, issue, amend, and rescind such rules and regulations and such orders as it may deem necessary or appropriate to carry out the provisions of this title . . . ." See Report of the SEC on the Policy Implications of Investment Company Growth, 89th Cong. 2d Sess., H. R. Rep. 2337, p. 343 (1966). We find it difficult to discern any truly significant difference; the Commission's purpose seems to have been to still arguments spawned by slight variations in the language of the acts it administers rather than to achieve power theretofore denied.

varieties in which participation by an investment company may be "different from or less advantageous than that" of an affiliate are infinite. The Commission could well have concluded that an attempt to specify these might fail to accomplish the Congressional purpose in some instances and in others accomplish more than Congress desired, and that the only effective method of regulation was to require advance disclosure and individual decision, at least until a pattern emerged, cf. note 7. Furthermore, as the Commission points out in brief, the public notice and opportunity for interested persons to come forward provided by the application procedure may lead to the development of significant facts that would not otherwise have been disclosed.

Industries mounts a counter-argument based on legislative history. It tells us that the Senate version of what became the Investment Company Act, S. 3580, 76th Cong. 3d Sess. (1940), included as §17(a)(4) a flat prohibition against affiliated persons' effecting transactions in which an investment company was a joint or a joint and several participant; relief would have been obtainable, as is now the case with respect to §17(a)(1), (2) and (3), by application for an exmption under §17(b). The change to the final version in which such transactions are condemned only insofar as they violate a particular standard, to be further specified in rules issued by the SEC, thus contraindicates an intention that the Commission may require advance application and approval in all instances. While this is a possible inference, it is equally likely that Congress meant only that such transactions should be governed only by the standard limned in §17(d) rather than the much more general ones of §17(b). We thus do not find the legislative history so compelling as to warrant a con-

clusion that Congress meant to deny the SEC power to utilize a method of regulation it had successfully used in other areas.

IV.

Our reversal of the judgment dismissing the complaint does not imply any belief on our part that the SEC is entitled to the drastic relief sought. Cf. *SEC* v. *Midwest Technical Development Corp., supra,* at p. 94,154. This action is not one for enforcement of an order making such directions, where weight must be given to the agency's selection of remedy. It is a suit in equity, whose essence lies in "the power of the Chancellor to do equity and mould each decree to the necessities of the particular case." *Hecht Co.* v. *Bowles,* 321 U. S. 321, 329 (1944).

The objective of §17(d) of the Investment Company Act is to prevent affiliated persons from injuring the interests of stockholders of registered investment companies by causing the company to participate "on a basis different from or less advantageous than that of such other participant." On the face of things that has not happened here up to this time, and the objective for a court of equity must be to insure that it does not happen in the future. While we do not undertake to particularize the form of a decree, a prohibition against sale of its shares by Industries without according Fund a fair opportunity to participate would be one obvious device to that end. On the other hand, as at present advised, we fail to perceive how the interest of Fund's stockholders would be advanced by such provisions as requiring Industries and Fund to withdraw votes cast at the April 22 stockholders' meeting of General Time and enjoining further voting by them. Requirements of that sort would have a strong tendency to induce forced liquidation at least on the part of Industries,

which surely did not make its large investment in order to be a voteless minority stockholder in General Time, and this might well be detrimental rather than advantageous to the stockholders of Fund. Whether or not General Time had sufficient standing to direct judicial attention to the violation of §17(d), an issue on which we have no occasion to pass, protection of the interests of its management in retention in office is not an objective of that section. While an order going beyond what would otherwise be the necessities of the case may sometimes be justified as against a deliberate flouter of regulatory statutes, Industries and Fund cannot be so regarded. Section 17(d) had been rarely construed, the only reported cases cited to us in addition to *SEC* v. *Midwest Technical Development Corp., supra,* being one portion of a decision of the Commission under the Securities Exchange Act, *Imperial Financial Services, Inc.*, Securities Act Release No. 7684 at 8-10 (1965), and a portion of a very recent case dealing primarily with §17(a), *Fifth Ave. Coach Lines, Inc.* Investment Company Act Release No. 5214, December 27, 1967. No decided case had ever applied §17(d) to a situation like that here, and conscientious counsel could well have believed the reservations Chestnutt stated were sufficient to make it inapplicable.

The judgment dismissing the complaint is reversed, with directions to the District Court to proceed promptly to formulate an injunction consistent with this opinion. The stay of the reconvening of the annual meeting of General Time will remain in effect until such injunction is issued.

Appendix B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

68 Civ. 1762

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

TALLEY INDUSTRIES, INC., AMERICAN INVESTORS FUND, INC., CHESTNUTT CORPORATION and GENERAL TIME CORPORATION,

Defendants.

Philip A. Loomis, Jr., General Counsel, David Ferber, Solicitor, John A. Dudley, Harold Sweetwood, Antony A. Venturo, Janet G. Gamer, Securities and Exchange Commission, Washington, D. C. for plaintiff.

(Marlon M. M. Frankhauser, Richard V. Bandler, Edwin H. Nordlieger, Securities and Exchange Commission, of Counsel.)

Donovan Leisure Newton & Irvine, by Walter L. Stratton, New York, New York, for defendant Talley Industries, Inc.

(Breck P. McAllister, Roy W. McDonald, Roger W. Kapp, Robert S. Ogden, Jr., Ben Vinar, William J. T. Brown, of Counsel.)

O'Connor & Farber, New York, New York, for defendants American Investors Fund, Inc. and Chestnutt Corporation, (Clendon H. Lee, of Counsel).

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Chadbourne, Parke, Whiteside & Wolff, New York, New York, for defendant General Time Corporation, (P. G. Pennoyer, Jr., of Counsel).

WYATT, District Judge: This is the decision after trial to the Court without a jury.

There was a motion for plaintiff Securities and Exchange Commission (SEC) for a preliminary injunction restraining in certain respects defendants Talley Industries, Inc. (Talley), American Investors Fund, Inc. (Fund) and Chestnutt Corporation. The principal relief sought by SEC was to require Talley and Fund to withdraw votes cast by them at the April 22, 1968 annual meeting of shareholders of General Time Corporation (Time).

Between December 26, 1967 and April 22, 1968, Talley bought in the open market 257,937 shares of common stock of Time; Fund in the same period bought 210,000 such shares.

The claim of SEC is that these shares were bought in violation of Section 17(d) of the Investment Company Act of 1940 (the Act; 15 U. S. C. § 80a-1 and following; Section 17(d) of the Act is 15 U. S. C. § 80a-17(d)) and of Rule 17d-1 (17 CFR § 270.17d-1) issued thereunder.

The action is brought under Section 42(e) of the Act (15 U. S. C. § 41(e) to enjoin alleged violations of that Act.

At the beginning of the hearing of the application for a preliminary injunction, the parties agreed that the Court should order the trial of the action on the merits to be advanced and consolidated with the application; this was done.

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There must be judgment for defendants.

Section 17(d) of the Act makes it unlawful for "any affiliate person of . . . a registered investment company . . . acting as principal to effect any transaction in which such registered company . . . is a joint or a joint and several participant with such person . . . in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such registered . . . company on a basis different from or less advantageous than that of such other participant."

It will be noted that conduct to be "unlawful" under Section 17(d), must be in contravention of some rule or regulation of SEC issued under the authority of Section 17(d).

The SEC has issued Rule 17d-1 (1 CFR § 270.17d-1) which reads in part as follows:

> "(a) No affiliated person of . . . any registered investment company . . . acting as principal, shall participate in, or effect any transaction in connection with, any joint enterprise or other joint arrangement or profit sharing plan in which any such registered company . . . is a participant . . . unless an application regarding such joint enterprise, arrangement or profit sharing plan has been filed with the Commission and has been granted . . . ."

The SEC has alsc in the same Rule (17 CFR § 270.17d-1 (c)) broadly defined "joint enterprise or other joint arrangement or profit-sharing plan."

It seems clear that it is within the power of the SEC to require by Regulation under Section 17(d) of the Act

that unless application in advance has been made to the SEC and granted, no affiliated person of a registered investment company acting as principal shall effect any transaction in which such registered company is a joint or a joint and several participant. On the other hand, it is also clear that by the use of such expressions as "joint enterprise or other joint arrangement or profit-sharing plan" the SEC cannot widen the reach of the statute.

The effect of the Rule 17d-1 in the case at bar, therefore, is to raise the issue of the legality of the stock purchases by Fund and by Talley.

Fund is a "registered investment company" under the Act.

Talley is an "affiliated person" of Fund because at all relevant times Fund has owned between 9% and 10% of the outstanding voting securities of Talley. 15 U. S. C. § 80a-2(a)(3)(B).

The issue in this action, therefore, is whether the purchase of Time shares by Talley or Fund or both was a "transaction" effected by Talley as "principal" in which Fund was a "joint" or joint and several participant."

Talley is a Delaware corporation with its principal office in Mesa, Arizona, some twenty miles from Phoenix. Its shares are publicly held and listed on the American Stock Exchange. Talley makes products for use as parts of jet aircraft and other space age systems and devices. Franz G. Talley (Franz) is president and the chief figure for Talley in the events in suit.

Fund is a New York corporation with its principal office in Greenwich, Connecticut. It is an investment company (a so-called "mutual fund") with assets, consisting of in-

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vestments in portfolio companies, having a market value of some 270 million dollars. George A. Chestnutt, Jr. (George) is president and the chief figure for Fund in the events in suit.

No officer or director of Fund is an officer or director of Talley and no officer or director of Talley is an officer or director of Fund. Talley owns no shares of Fund. The shares of Talley owned by Fund were bought in the open market; there have never been any transactions between Talley and Fund.

Time is also a Delaware corporation, the common stock of which is listed on the New York Stock Exchange. The principal office of Time is in Connecticut. It makes all kinds of clocks, timing devices and related equipment.

In about April 1967, Fund sent a representative to look over the Talley plant in Arizona; later in 1967 Franz and his daughter visited the Fund offices in Greenwich and had lunch with George.

Talley has been interested in acquiring other companies; it has had "a very active acquisition program" and in this connection has consulted M. Kimelman & Company (Kimelman), a brokerage firm in New York. The chief figure for Kimelman in the events in suit was Michael Kimelman (Mike), a partner.

Franz, as custodian for his two children, had an account with Kimelman.

Mike in December 1967 became interested in Time as an investment and exercising his discretion bought for the Franz custodian account on December 22, 1967, 400 shares of Time at about $23 per share.

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Franz learned of this purchase only from the confirmation slips but about the same time Mike telephoned him, discussed Time as an investment, and sent Franz a report on Time. Mike also suggested Time as a potential acquisition or merger candidate for Talley.

After studying the report, Franz gave Mike an order to buy for Talley about half to three quarter million dollars in purchase price of Time stock. Franz was seriously considering Time as a merger candidate. Mike executed the order by buying 24,800 shares on December 26 and 27, 1967.

On December 29, Franz talked to George and brought to his attention the advantages of Time as an investment for Fund, stating that Talley had bought shares of Time and that it was a possible acquisition for Talley. Undoubtedly a motive for Franz was that if acquisition or merger were attempted, shares in the hands of Fund could be presumed friendly to Talley. George broke off the conversation in order to consult counsel to Fund and did so. George then talked to Franz again and said there was no legal reason why Fund should not buy shares of Time, provided that there was no agreement with Talley as to how the shares would be voted, that Fund could dispose of its shares at any moment, that it was completely independent of Talley and had no agreement with Talley about the shares.

On January 2 and 3, 1968, Talley bought through Kimelman 42,000 shares of Time.

Franz then sent Mike to see George about January 3, 1968, and, after getting further information about Time, George decided to buy for Fund just under 10% of the outstanding shares of Time or 210,000 shares. The order

to buy was given to Kimelman on January 5. It is clear that George made an independent decision for Fund to buy these shares, believing it to be a good investment for Fund. One of the factors in his investment decision was the possibility that Talley might acquire or merge with Time. It is also clear that George made an independent decision to use Kimelman as broker, largely because Kimelman already knew of Fund's interest in Time and of Talley's interest; using Kimelman would tend to limit the knowledge in financial circles that Fund was accumulating Time stock; the more widely it was known that Fund was buying Time shares, the stronger the upward effect on share prices would be; using brokers normally employed by Fund would tend to identify Fund as buying.

Between January 5 and February 15, 1968, Kimelman bought for Fund 210,000 shares of Time at an average price of $28.49 per share.

During the same period, Talley bought 35,300 Time shares and sold 50,000 shares, one block of 10,000 shares having been sold on January 17 and 40,000 shares having been sold on February 2. The sale of 10,000 shares appears to have been made at a point when Franz was considering with counsel the possibility of offering cash or Talley stock for shares of Time; he was advised that a tax-free ruling on such an offer could not be secured if Talley itself already owned a substantial number of shares bought for cash. The sale of 40,000 shares was to a friend of Franz; in the hands of the friend, the shares would be voted as Franz wished and Talley was relieved to that extent of the investment of funds.

Thus, at the time Fund completed its purchase of 210,000 shares on February 15, Talley owned 52,100 shares.

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By this time Franz was definitely attempting to lay the foundation for an acquisition of or merger with Time. He learned that the record date for the annual meeting of stockholders of Time to be held in 1968 was March 1, 1968; this meant that more shares had to be acquired by Talley before that date.

On February 19 Talley, against the advice of George, made a "special bid" on the Stock Exchange for 200,000 Time shares at $36.50 per share. Talley bought 66,437 shares under this bid.

As a result of the special bid, the management of Time learned that Talley was accumulating Time shares.

There was a meeting on February 19 between Talley and Time people, during which Franz emphasized his interest in a "friendly merger".

On the same day, February 19, Time management issued a press release that the $36.50 Talley bid was inadequate; the price then went up, Talley obtained the 66,437 shares only, and the bid was terminated.

Later on February 19 Time management sent word to Franz that they had decided to fight Talley rather than to try to arrange a "friendly merger".

On February 21, Talley bought through Kimelman 73,200 shares in the open market and in the same fashion 66,200 shares on February 23. This completed the purchases by Talley.

Talley after February 23 owned 257,937 shares of Time bought at an average cost of $38.99 per share.

On February 24, Time commenced an action in this Court (68 Civ. 768; sometimes "the first action") against Fund,

Talley and others. The complaint averred that the purchases of Time stock by defendants had been in violation of Section 17(d) of the Act, of Section 13(a) of the Act, and of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78a and following) and of Regulation 10b-5 issued by SEC thereunder. An injunction was asked against voting by Fund and Talley of their shares of Time, against any merger of Time and Talley, against obtaining any more shares in violation of the Act, etc.

By late February or early March 1968, Franz had determined to engage in a proxy fight for control of Time, to be determined by the election of directors of Time at the annual meeting of stockholders on April 22. Franz selected 10 nominees of an "Independent Stockholders Committee" of Time; the Committee was entirely financed by Talley and was to solicit proxies in favor of its nominees, its object being to oust the management of Time. Fund had nothing whatever to do with the decision to begin the proxy fight nor with the selection of the nominees for directors. Fund had made no commitment how it would vote its stock and was perfectly free to vote for whatever slate Fund itself decided to vote.

A list of stockholders of Time was demanded by Talley. The management of Time refused. Litigation in Delaware followed and on March 21 Talley obtained the list.

Meanwhile Talley was attempting to clear its proxy material with the SEC. Under the applicable Rules (for example, 17 CFR § 240.14a-6), proxy soliciting material must be filed with the SEC ten days before being sent to stockholders; on a showing of "good cause", however, the SEC may shorten the period (usually called, to "clear" the material), a great advantage to those soliciting.

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It is here asserted for Talley, and not denied, that on March 25 someone on the staff of SEC advised counsel for Talley that, unless an application were filed under Rule 17d-1 for approval of the purchases of Time shares by Fund and Talley, the proxy soliciting material would not be cleared by the SEC; that under such compulsion, Talley agreed to file such an application; and that thereupon the proxy soliciting material was cleared.

Thus, on March 27 Talley filed an application under Rule 17d-1 describing the purchase of Time shares by it, by Fund and by others. The application requested an order by the SEC "dismissing the Application as not encompassing transactions subject to Section 17(d) or Rule 17d-1 or, alternatively, . . . finding that the transactions hereinabove described are consistent with the provisions, policies and purposes of the Act and that the participation by the Fund therein is not on a basis different from or less advantageous than that of the other participants and granting this Application of Talley to approve such participation by it . . .". On the same day Fund joined in the application.

The following note appeared at the beginning of the application:

> "Talley Industries, Inc. disclaims that the transactions described herein are in any manner within the purview of Section 17(d) of the Investment Company Act of 1940 or any rule adopted thereunder and accordingly does not concede that the making of this Application, or a decision of the Securities and Exchange Commission with respect to the subject matter hereof, is required; nor does Talley Industries, Inc. concede that the Securities

and Exchange Commission has jurisdiction over the subject matter of this Application."

Having received the Rule 17d-1 application, the SEC on April 2 gave notice of a hearing on April 16 to consider the application.

On the next day (April 3), Senator Percy wrote to the Chairman of the SEC on stationery of the Senate Committee on Banking and Currency. This letter was inspired by the management of Time, as the Senator himself appears to concede, and was directed to the body which had just given notice of an impartial hearing on the Talley-Fund application. The letter spoke of the interest of the SEC in new legislation passed by the Senate last year to prevent "such abuses" as the "current takeover bid" by Talley. The evidence on which the Senator based his conclusion that Talley had committed an abuse was not given. Apparently the Senator was under the impression that it was part of the "tender offer situation", although Talley had made no "tender offer"; the "special bid" made on February 19 under Stock Exchange rules could scarcely be called a "tender offer". In any event, the Senator referred to the "possible utility of this case as one in which your Commission could make its attitude on and concern for these sorts of takeovers very clear to the business community". The Senator expressed himself as "gratified" that the SEC had taken note of "this serious situation" and had ordered a hearing. But the Senator was concerned that the April 22 meeting of Time would take place before the SEC could determine the issues and that if Talley won control there would be "considerable disruption". Therefore the Senator suggested that "action by your Commission in the Court to temporarily suspend

the situation and postpone the meeting would be consistent with the maintenance of your Commission's jurisdiction in the matter". Meanwhile the Senator expressed his appreciation for the "forthright action" which the SEC had already taken and his hope that SEC "will make every effort to assure that the matter is resolved in a manner which recognizes the best interests of the parties involved".

Apparently the letter of Senator Percy was hand carried to the SEC which called a session for April 4 at which counsel for Time and for Talley were present. Counsel for Time urged the SEC to bring an action in the courts against Talley and apparently there was discussion of the possibility that Time itself might bring such an action.

On the following day (April 5) the SEC indicated that it would not bring the action requested. On the same day (April 5) Time itself commenced a second action (68 Civ. 1399) in this Court. Named as defendants were Talley, Fund, the independent Stockholders Committee, and others. The charge in the complaint was that the Talley proxy soliciting material was false and misleading and therefore in violation of Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. § 78a and following) and Rules of the SEC thereunder. The relief demanded was substantially the same as that sought in the first action, namely, an injunction against voting by Fund and Talley of their shares of Time, etc.

On the day the second action was commenced, an order to show cause was obtained by Time to bring on a motion for a preliminary injunction. This motion by Time was heard on April 8 by Judge Tyler, who filed on April 12 an order with opinion denying the motion. Judge Tyler

found that the materials sent out by Talley were "sufficiently exhaustive, concise, and, so far as the facts have been brought out in the preliminary hearing, true". Judge Tyler found that stockholders of Time could make an "informed choice" between the Time management and Talley.

On April 13, Time and The Seeburg Corporation announced a plan to merge Time and Seeburg "contingent upon the continuation of General Time's present management"; the terms of the proposed merger were announced.

On April 15, the SEC granted Time "leave to be heard" in the Rule 17d-1 application proceedings but denied leave to intervene.

On April 18, Judge Bryan filed an order with opinion dismissing the first action brought by Time. Judge Bryan found that Time had no standing to sue under the Act because the Act was intended to protect those having an interest in the registered investment company (Fund), specifically that Section 17(d) "was intended to protect the Fund shareholders from having their company enter into transactions with affiliates on inequitable terms". Judge Bryan rejected any claim under Rule 10b-5 because Time, the corporation, could not be injured "in a takeover situation" and that "incumbent management has no protected interest in remaining in power".

George studied the proposed Time-Seeburg merger and found it very unattractive, estimating the value given in the merger to be about $28 per Time share against a then market value of about $35 per share. George accordingly issued a statement for Fund on April 18 that he would recommend voting Fund's stock in favor of the Talley slate and the Fund directors so decided.

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The hearing before the SEC Hearing Examiner on the Rule 17d-1 application took place on April 16, 17 and 18, being concluded in the evening of April 18. Apparently having in mind the April 22 stockholders meeting of Time, the Hearing Examiner referred the matter at once to the Commission. There was oral argument before the Commission beginning at 2:30 in the afternoon of Friday, April 19. Before the argument began it was announced that a majority of the Commission had "tentatively determined" that there had been a "joint arrangement" between Talley and Fund in violation of Section 17(d) of the Act and of Rule 17d-1 and that there was no "warranty" for any retroactive approval. Counsel were advised to address themselves to "those questions". The oral argument concluded at 3:45 p.m.

The Commission at about 5:00 p.m. on the same day (April 19) made its "Memorandum Opinion and Order". It was found that the "broad language" of Section 17(d) and Rule 17d-1 indicated that the term "joint arrangement" which does not appear in the statute but only in the Rule) "should not be given a narrow interpretation". It was found that Talley and Fund had carried out a "joint arrangement" and that purchase by Talley of Time shares "pursuant to its joint arrangement was accordingly in violation of the Act". The "joint application" was denied.

There was no finding by the SEC that purchases by *Fund* were in violation of the Act. The significance of this omission will appear.

Armed with the order of the SEC, Time now made haste to this Court and in the second action appeared before Judge Tyler at ten o'clock in the morning of Monday, April 22. The Annual Meeting of Time was scheduled to

begin at two in the afternoon of that day at Stamford, Connecticut. On the basis of the SEC order, Time asked Judge Tyler to enjoin Talley from voting its shares and proxies or alternatively to adjourn the meeting. After full argument, Judge Tyler that morning declined to issue any injunction.

The meeting of stockholders of Time was duly held on April 22 and according to testimony at the trial the nominees for Talley were elected as directors of Time by some 96,000 votes.

This action was then commenced by the SEC on May 1.

The SEC allowed itself to be persuaded, unwisely as it seems to me, to throw its weight on the side of one of two contending factions in a situation where the stockholders of Time—the real parties in interest—were being given an opportunity, as Judge Tyler found, in the exercise of corporate democracy to make an "informed choice".

The wisdom of the SEC action, of course, is not one for me to decide. The sole issue is simply: did the purchases by Fund or Talley or both violate Section 17(d) of the Act?

Careful study has been given of the arguments for the SEC and for Time and no merit can be found in any of them.

Three points can be put to one side in the beginning.

First, it is not possible as a matter of law for purchases by Fund to be in violation of Section 17(d). This is because that Section only makes unlawful an activity by an "affiliated person", in this case Talley, and does not make unlawful any activity of "a registered investment

company", in this case Fund. The SEC itself appears to recognize this because its April 19 order finds only that purchases by Talley were in violation of Section 17(d) and significantly omits that purchases by Fund were in violation of the Act.

Second, Rule 17d-1 to the extent that it goes beyond Section 17(d) is invalid because without authority. Therefore, the words of the Rule, "joint enterprise or other joint arrangement or profit-sharing plan", and the definition of those words cannot serve to extend the sweep of the Act. The Rule is valid, however, if applied to a situation covered by Section 17(d).

Third, the determinations made by the SEC in its April 19 order need not be accepted by this Court. Naturally, findings of fact and conclusions of law by the able and conscientious Commissioners who acted here will be given respectful consideration, as has been done. But this is an independent civil action commenced by the SEC as a litigant in this Court, under authority of Section 42(e) of the Act (15 U. S. C. § 80a-41(e)). It is not a judicial review of an order under Section 43 of the Act (15 U.S.C. § 80a-42) and even if it were, judicial review would be meaningless if the Court were obliged to accept the determinations in the order of the SEC. The case at bar is brought under a statute virtually the same as that under which *SEC v. Frank,* 388 F. 2d 486 (2d Cir. 1968) was brought and in which Judge Friendly (at 491) said:

> "The language here, however, like that in other statutes, . . . authorizes the Commission to bring an action for an injunction 'whenever it shall appear' to it that a violation is or is about to be committed; it does not specify whether a court should give

weight to the Commission's judgment, simply stating that upon 'a proper showing' an injunction 'shall be granted.' Such bland language affords no sufficient basis for concluding that Congress meant special weight to be given the Commission's decision to allow its staff to institute suit. If Congress wishes to go further, it should say so in language all can understand."

The remaining question, decisive of the action, is whether in its purchases of Time shares, Talley "as principal" effected a "transaction" in which Fund was a "joint or joint and several participant".

That Talley, when it bought Time shares, acted "as principal" and effected a "transaction" is plain. It seems equally plain that Fund was not "a joint or a joint and several participant" with Talley in the "transaction" of purchase. Fund has no financial interest of any sort in the shares of Time bought by Talley nor any agreement, understanding or commitment of any sort ever to have any such interest. There is no conceivable way by which Fund can be in any way affected financially by the purchase by Talley of the shares.

The purchases by Talley of shares of Time were not within the language of Section 17(d) and no application to the SEC was required, or could be required by the SEC, under Rule 17d-1 or otherwise.

While this disposes of the action, a few words may be added.

Our Court of Appeals, through Judge Friendly, has not long ago spoken aptly about the Act (*Willheim* v. *Murchison*, 342 F. 2d 33, 42 (1965)):

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> "The Investment Company Act, the product of joint effort and compromise by the SEC and the industry, was drafted with a good deal of specificity; a court should give it a hospitable reception but ought not expand its words beyond their natural meaning to bring within its sweep a transaction, such as that here at issue, which is not the 'mischief and defect' aimed at by the Act and which it is doubtful that Congress would have wished to include if it had considered the problem."

The situation in the case at bar is not even remotely a "mischief and defect" at which Section 17 is aimed.

Section 17, as Judge Friendly in *Wellheim* elsewhere (at 40) pointed out, was aimed by Congress at "certain kinds of self-dealing".

The "self-dealing" at which Section 17 was aimed was that between the investment company and insiders.

The Act was passed in 1940 after a monumental study of investment companies had been made by the SEC, naturally with special emphasis on the mischiefs and defects revealed after the stock market crash in 1929. One of these, at which Section 17 was directed was described by one of the draftsmen of the Act, as follows (Jaretzki, The Investment Company Act of 1940, 26 Wash. U. L. Q. 303, 307, 317-18 (1941)):

> "Dealings *between* investment companies and affiliated persons . . . also made possible improper transactions by the unscrupulous." (emphasis added)

* * *

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> "The charge had been made that investment companies frequently were operated, not primarily in the interests of their stockholders, but in the interests of controlling groups or groups represented on the board of directors. Specifically, there have been instances of investment houses selling securities to affiliated investment companies under circumstances which at worst constituted a conscious unloading of securities on the investment company and at best a bad bargain for the investment company."

On the same subject, the SEC Report to Congress itself said (*Investment Trusts and Investment Companies*, Report of the Securities and Exchange Commission, Part Three, "Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies" 22 (1939)):

> "While the losses in a number of investment companies were attributable principally to the security market decline and general business decline, in many cases the substantial losses sustained by investment companies were the result of the numerous transactions which the sponsors, managers, officers, directors, and other controlling interests effected for their own account with the investment companies which they dominated."

The SEC has more recently described the aim of Section 17(d) as follows:

> "[R]egulate certain situations where persons making the investment decisions for the registered . . . company may have a conflict of interest and the

> danger exists that the investment company . . . may be overreached by such affiliated persons . . . ." Investment Company Act Release No. 5128 (October 13, 1967).

Judge Bryan, in dismissing the first action brought by Time in this Court, stated with specific reference to Section 17(d):

> ". . . the proscription of unapproved joint arrangements with affiliates was intended to protect the Fund shareholders from having their company enter into transactions with affiliates on inequitable terms."

When Talley bought its Time shares here, there was no possibility that Fund would be "overreached" or that "inequitable terms" would be imposed on Fund. The purchases had no financial effect on Fund and never could have. Fund had no interest of any sort in the shares bought by Talley.

True, Fund itself in separate transactions bought on its own judgment and solely for its own account 210,000 shares of Time. For all that appears, Fund made a good investment. (While irrelevant, it may be noticed that the average cost to Fund of its Time shares was $28.49 per share while the average cost to Talley was $38.99 per share.) In any event, whether Fund made a good investment or not, Section 17(d) does not apply to Fund, the "registered investment company."

What has been written above contains the findings of fact and conclusions of law required by Fed. R. Civ. P. 52(a).

The Clerk is directed to enter judgment dismissing the action as to all defendants.

So Ordered.

Appendix C

INVESTMENT COMPANY ACT OF 1940

SEC. 1.

(b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors are adversely affected—

(1) when investors purchase, pay for, exchange, receive dividends upon, vote, refrain from voting, sell, or surrender securities issued by investment companies without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management;

(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;

(3) when investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders of their outstanding securities;

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(4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed, or when investment companies are managed by irresponsible persons;

(5) when investment companies, in keeping their accounts, in maintaining reserves, and in computing their earnings and the asset value of their outstanding securities, employ unsound or misleading methods, or are not subjected to adequate independent scrutiny;

(6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;

(7) when investment companies by excessive borrowing and the issuance of excessive amounts of senior securities increase unduly the speculative character of their junior securities; or

(8) when investment companies operate without adequate assets or reserves.

It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.

SEC. 2. (a) When used in this title, unless the context otherwise requires—

* * *

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(3) "Affiliated person" of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

SEC. 17.

* * *

(d) It shall be unlawful for any affiliated person of or principal underwriter for a registered investment company (other than a company of the character described in section 12 (d) (3) (A) and (B), or any affiliated person of such a person or principal underwriter, acting as principal to affect any transaction in which such registered company, or a company controlled by such registered company, is a joint or a joint and several participant with such person, principal underwriter, or affiliated person, in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant. Nothing contained in this subsection shall be deemed to preclude any affiliated person from acting as manager of any underwriting syndicate

or other group in which such registered or controlled company is a participant and receiving compensation therefor.

SEC. 42.

* * *

(e) Whenever it shall appear to the Commission that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this title, or of any rule, regulation, or order hereunder, it may in its discretion bring an action in the proper district court of the United States, or the proper United States court of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this title or any rule, regulation, or order hereunder. Upon a showing that such person has engaged or is about to engage in any such act or practice, a permanent or temporary injunction or decree or restraining order shall be granted without bond. In any proceeding under this subsection to enforce compliance with section 7, the court as a court of equity may, to the extent it deems necessary or appropriate, take exclusive jurisdiction and possession of the investment company or companies involved and the books, records, and assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, who with the approval of the court shall have power to dispose of any or all of such assets, subject to such terms and conditions as the court may prescribe. The Commission may transmit such evidence as may be available concerning any violation of the provisions of this title, or of any rule, regulation, or other thereunder, to the Attorney General, who, in his discretion, may institute the appropriate criminal proceedings under this title.

Appendix C

RULE 17D—1. APPLICATIONS REGARDING JOINT ENTERPRISES OR ARRANGEMENTS AND CERTAIN PROFIT-SHARING PLANS.

(*a*) No affiliated person of or principal underwriter for any registered investment company (other than a company of the chartacter described in Section 12(d) (3) (A) and (B) of the Act) and no affiliated person of such a person or principal underwriter, acting as principal, shall participate in, or effect any transaction in connection with, any joint enterprise or other joint arrangement or profit-sharing plan in which any such registered company, or a company controlled by such registered company, is a participant, and which is entered into, adopted or modified subsequent to the effective date of this rule, unless an application regarding such joint enterprise, arrangement or profit-sharing plan has been filed with the Commission and has been granted by an order entered prior to the submission of such plan or modification to security holders for approval or prior to such adoption or modification if not so submitted, except that the provisions of this rule shall not preclude any affiliated person from acting as manager of any underwriting syndicate or other group in which such registered or controlled company is a participant and receiving compensation therefor.

(*b*) In passing upon such applications, the Commission will consider whether the participation of such registered or controlled company in such joint enterprise, joint arrangement or profit-sharing plan on the basis proposed is consistent with the provisions, policies and purposes of the Act and the extent to which such participation is on a basis different from or less advantageous than that of other participants.

(*c*) "Joint enterprise or other joint arrangement or profit-sharing plan" as used in this rule shall mean any

written or oral plan, contract, authorization or arrangement, or any practice or understanding concerning an enterprise or undertaking whereby a registered investment company or a controlled company thereof and any affiliated person of or a principal underwriter for such registered investment company, or any affiliated person of such a person or principal underwriter, have a joint or a joint and several participation, or share in the profits of such enterprise or undertaking, but shall not include an investment advisory contract subject to Section 15 of the Act.

(*d*) Notwithstanding the requirements of paragraph (*a*) above, no application need be filed pursuant to this rule with respect to any of the following:

(1) Any profit-sharing plan provided by any controlled company which is not an investment company for its officers or employees, provided no affiliated person of any investment company which is an affiliated person of such controlled company participates therein.

(2) Any plan provided by any registered investment company or any controlled company for its officers or employees if such plan has been qualified under Section 401 of the Internal Revenue Code of 1954 and all contributions paid under said plan by the employer qualify as deductible under Section 404 of said Code.

(3) Any loan or advance of credit to, or acquisition of securities or other property of, a small business concern, or any agreement to do any of the foregoing, ("Investments") made by a bank and a small business investment company (SBIC) licensed under the Small Business Investment Act

of 1958, whether such transactions are contemporaneous or separated in time, where the bank is an affiliated person of either (*i*) the SBIC; or (*ii*) an affiliated person of the SBIC; but reports containing pertinent details as to investments and transactions relating thereto shall be made at such time, on such forms and by such persons as the Commission may from time to time prescribe.[1]

[1] Applicable only to small business investment companies licensed under the Small Business Investment Act of 1958.

Appendix D

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

April 19, 1968

In the Matter of

TALLEY INDUSTRIES, INC.
3500 North Greenfield Road
Mesa, Arizona

AMERICAN INVESTORS FUND, INC.
88 Field Point Road
Greenwich, Connecticut
(812-2302)

Investment Company Act of 1940—
Section 17(d)

MEMORANDUM OPINION AND ORDER DENYING APPLICATION

American Investors Fund, Inc. ("AIF"), an open-end diversified management investment company registered under the Investment Company Act of 1940 ("Act") and Talley Industries, Inc. ("Industries"), an affiliate of AIF within the meaning of Section 2(a)(3) of the Act,[1] have

[1] Since August 8, 1967, AIF has owned more than 5 percent of the outstanding common stock of Industries.

filed a joint application for an order declaring that certain transactions described in the application including purchases of stock of General Time Corporation ("GTC") by them and certain affiliates of Industries are not subject to the provisions of Section 17(d) of the Act and Rule 17d-1 thereunder, or, in the alternative, for an order approving such transactions. After appropriate notice hearings were held at which GTC was granted leave to be heard.

At the conclusion of the applicants' presentation of their evidence in support of the application, the hearing examiner without objection referred the matter to us, and we heard oral argument by applicants and GTC. On the basis of our review we make the following findings.

Section 17(d) of the Act and Rule 17d-1 thereunder prohibit an affiliated person of an investment company, acting as principal, from participating in or effecting any transaction in connection with any joint enterprise or other joint arrangement or profit sharing plan in which any such registered company is a participant unless an application concerning such arrangement has been approved by us. The evidence adduced before the hearing examiner bearing on the issue of whether the transactions in question involved a joint arrangement within the ambit of these provisions detailed the facts surrounding those transactions. It shows that on or about December 29, 1967, Franz G. Talley, president of Industries, telephoned George A. Chestnutt, Jr., president of AIF and of Chestnutt Corporation, AIF's investment adviser, and told him that he was buying GTC stock for Industries and had in mind a possible future merger of Industries and GTC. Talley told Chestnutt that Industries had acquired and would continue to purchase GTC stock, which is listed on the New York

Stock Exchange, through the broker-dealer firm of M. Kimelman & Co., ("MKC"), and asked Chestnutt if AIF would consider buying GTC stock for its investment portfolio. Although AIF's rating of GTC stock was somewhat below the range AIF normaly considered desirable for purchase, Chestnutt felt that because of the merger possibility GTC stock had "a very good chance of going up in price" and was attractive. Chestnutt testified that he did not at that time tell Talley whether AIF would purchase any GTC stock but did state that no commitment would be made to Talley with respect to either voting or selling any stock that was purchased. He admitted, however, that he was sure that Talley considered that any GTC stock which AIF might purchase would be "in friendly hands." He acceded to Talley's request that any purchases of GTC stock be made only for AIF and not for other accounts managed by Chestnutt.

At Talley's suggestion Chestnutt met with Michael Kimelman and another partner in MKC on January 3, 1968 to discuss GTC, and the following day Chestnutt decided to purchase the stock for AIF. He then discussed with Talley the advisability of using different brokers to acquire GTC stock but, according to Chestnutt, they realized that if they did so they "might wind up bidding against each other for the same block of stock." On January 5, 1968, AIF placed an order with MKC for this purchase, at times to be determined by MKC in light of market conditions, of 205,000 shares of GTC stock, later increased to 210,000 shares. Between January 5 and February 15, 1968, MKC filled AIF's order, acquiring the 210,000 shares at an average cost of $28.49 per share. Industries acquired a net total of 257,937 shares between December 26, 1967 and February 23, 1968 at an average

cost of $36.76 per share, of which 205,837 shares were acquired following completion of AIF's acquisitions and all except 66,437 shares were acquired through MKC. During this period, Talley kept Chestnutt advised of how the stock acquisition program of Industries and Talley and his "friends" was progressing.

Under these circumstances, we think it clear that Industries and AIF entered into and carried out a joint arrangement within the meaning of Section 17(d) and Rule 17d-1 to acquire GTC stock by concerted action. The broad language of that Section and Rule indicate that the term "joint arrangement" should not be given a narrow interpretation.[2] Here there was not a mere happenstance of simultaneous purchases of the same security by an investment company and its affiliate. On the contrary, at Industries' instigation it and AIF undertook a coordinated program of acquisitions of the GTC stock, through a common broker, MKC, pursuant to discussions between them and agreed mechanics for its execution. Further AIF was aware of Industries' ultimate objective of bringing about a merger and was influenced to purchase GTC shares by this possibility.

Section 17(d) and Rule 17d-1 therefore were applicable and required that an application regarding the joint arrangement be filed with and granted by us prior to the taking of any action. However, the requisite prior approval was not sought or obtained, and Industries'

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[2] *Midwest Technical Development Corporation*, CCH Fed. Sec. L. Rep. Par. 91252 (D. Minn., July 5, 1963).

acquisition of GTC shares pursuant to its joint arrrangement was accordingly in violation of the Act.[3]

We find no warrant for granting retroactive approval of the transactions effected in such violation. The requirement that joint arrangements and transactions by investment companies and affiliates be submitted to us for our examination before any steps are taken to carry them out is an important part of the regulatory structure which is designed to effectuate the provisions, policies and purposes of the Act. One who would ask that we disregard a failure to comply with that requirement has the burden of presenting a compelling showing that such failure was justified and that retroactive approval is not inconsistent with the statutory policies and purposes. We are unable to find that such burden has been satisfied in the present situation.

Accordingly, IT IS ORDERED that the joint application of Talley Industries, Inc. and American Investors Fund, Inc. for an order declaring that certain transactions were not subject to Section 17(d) of the Investment Company Act of 1940 and Rule 17d-1 thereunder, or, in the alternative, granting approval of such transactions, be, and it hereby is, denied.

By the Commission (Commissioners Owens, Budge, Wheat, and Smith), Chairman Cohen absent and not participating.

ORVAL L. DUBOIS
Secretary

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[3] *Imperial Financial Services, Inc.*, Securities Exchange Act Release No. 7684, pp. 8-10 (August 26, 1965).

We may also note that we have continuing jurisdiction under Section 17(d) and Rule 17d-1 over any future transfers by Industries of the GTC stock it has acquired in violation of these provisions.

Appendix E

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the thirty-first day of July, one thousand nine hundred and sixty-eight.

Present:

HON. HENRY J. FRIENDLY,
HON. PAUL R. HAYS,
HON. WILFRED FEINBERG,
Circuit Judges.

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

v.

TALLEY INDUSTRIES, INC., AMERICAN INVESTORS FUND, INC., CHESTNUTT CORPORATION and GENERAL TIME CORPORATION,

Defendants-Appellees.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the

Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed with directions to said District Court to proceed promptly to formulate an injunction consistent with the opinion of this court.

It is further ordered, adjudged and decreed that the stay of the reconvening of the Annual Meeting of General Time Corporation shall remain in effect until such injunction is issued.

A. DANIEL FUSARO
Clerk
By: VINCENT A. CARLIN
Chief Deputy Clerk